BACKGROUND

The application "Financial Instruments Derived from Root Products…" along with supplementary applications "Developing Root Products.." and "A Hybrid Trading Platform" are Continuation In Part of a nonprovisional application "Risk Management for Manufacturing" submitted in August 2000. Later on, another application for cash management system (Open Clearing System) was submitted to complete the risk management cycle. The basic idea was to introduce a comprehensive model of risk management to a new business environment of manufacturing. Such an application of risk management, as proven in financial markets, will enhance manufacturing efficiency and productivity.

OVERVIEW

The basic idea of designing semi standard "contract" is to facilitate liquidity of a multilateral trading platform. To do so a contracts must behave as standard non exclusive tradable financial instrument for transferring risk to a risk taker -who may not necessarily be a purchaser of goods nor an end user of physical product.

Contracts are two types: i) short tern and static covering exchange of goods and services including auction and, ii) long term and dynamic exchange of contracts exemplified as forwards and futures. The term general condition of contract means all conditions including legal, delivery dates and specifications of goods and service are fixed. The term particular conditions of contract refers to specific changes made to general condition due to particular goods or services of the contract. A semi standard contract then is a combination of fix and variable terms of contract. In manufacturing there are many contracts that fall into this category provided their exact value-added is quantified and unified. They are simply identified as "in-process", that is, from process A to B. The least value-added product is then, a root product. An example would be a copper bar or aluminum ingot or a chemical base material. Once these value-added products are established semi standard contracts are structured as combination of general condition (standard terms) and particular condition (product specific variable terms) of contract.

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OVERVIEW.

Contracts are of two types: i) short term and static covering exchange of goods and services manifested as standard auction and, ii) long term and dynamic exchange of contracts exemplified as forwards and futures exchange/auction. The term general condition of contract means all conditions including legal, delivery dates and specifications of goods and service are fixed. The term particular conditions of contract refers to specific changes made to general condition due to particular goods or services of the contract. A semi standard contract then is a combination of fix and variable terms of contract. In manufacturing there are many contracts that fall into this category provided their exact value-added is quantified and unified. They are simply identified as "in-process" materials, that is, from process A to B. The least value-added product is then, a root product; an example of which would be a copper bar or aluminum ingot or a chemical based element like sulfur. Once these value-added products are established semi standard contracts are structured as combination of general condition (standard terms) and particular condition (product specific variable terms) of contract.

BASIC IDEA

Most auctions designed for supply chain or retail business operate on short term contracts. Long term contracts, on the other hand, are incomplete such as forwards/futures, thereby exposing participants to risk of price change. In a risk management trading platform liquidity is an essential requirement to allow transfer of risk to a **risk taker** -who may not necessarily be a purchaser of goods nor an end user. Liquidity will, in turn, reduce spread between bid and ask, to theoretically zero, leading to price discovery. To ensure proper liquidity, the traded contract must be tradable in such a way that, theoretically, there always exist as many buyers as sellers and hence equilibrium. Clearly, a product must be fungible to be considered liquid. In the real world the trading forum for long term contracts require that such products be carefully researched, approved by regulatory bodies and tried for long periods before proving of value.

This invention is a liquidity -centric trading platform in three areas:

- The platform trades semi-standard contracts with some initial liquidity
- The matching process is so designed that market liquidity is "induced", that is, improving product liquidity through advanced matching process.
- The risk management mechanism of marked-to-market to ensure market integrity.

Prior Arts

1. Shepherd's patent 6,134,536 : Formulation and Trading of Risk management Contracts
Provides a methodology for risk management related to party/counterparty matching model. The ordering party's contract is clearly specific "product sponsor" as a non-standard and exclusive product. The matching is made against all sellers of that product. The contract is claimed to be re-traded repeatedly.

Distinction: Trading of risk management contracts requires three key elements: i) A continuous long term contract in a 2-sided auction model (both principal and agent) with sufficient liquidity that can be dynamically priced. ii) A formal structured contract with fixed specification and specified delivery date(s) to ensure sufficient market liquidity to be of effective. iii) Continuous monitoring of performance bond (both parties) to guarantee market integrity. This results in a price discovery essential for equilibrium. Shepherd's patent partially addresses (i)

2. Turbeville et al. Pub. No. US2001/027437A1 employs a pooling method for calculating credit risk coverage of parties; and as noted "particularly useful" that are generally illiquid. The method employs pooling of contract credits, averaging the contracts credit risks, comparing a contract with (maximum)credit risk coverage limit and decide whether to accept the contract in the pool.

Distinctions: The application, as noted, is neither designed nor adequately addresses the performance bond for non exclusive contracts traded in a 2-sided continuous auction which requires daily adjustment of cash based bond for both parties.

3. Dalal et al US Patent Publication No 2008/0040289- A flexible contract trading of multi-enterprise platforms discusses how a multi-lateral contract trading , many buyers-many sellers, in a supply chain application can improve price negotiation and ultimately optimize trading function. This is an enterprise based closed system not allowing risk takers to participate.

Distinctions: As in the case of Shepherd, the basic theme centers around the matching of prices and not the other requirements for market efficiency such as the tools needed for an efficient risk management. Both "option" and "forward" contracts are defined in an arbitrary manner that do not conform with financial engineering principles.